

Morocco's Economic Prospects and Challenges¹

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Morocco's favorable record of economic growth in recent years is likely to be set back by the global economic recession. Despite other favorable factors, the expected shrinkage of the EU economy, Morocco's main trading partner and the employer of some 2.5 million Moroccan workers, will exert a negative influence. After compiling a solid record in 2000-2006, GDP growth was set back by a drought in 2007 that sharply reduced cereal production: the overall growth rate dropped from 8% in 2006 to 3.2%. In 2008, however, growth bounced back to an estimated 5.4%. For 2009, the Moroccan government and central bank are still predicting 5% growth, but with the EU economy expected to contract by 4% or more in 2009 and perhaps shrink further in 2010, a considerably lower 2009 growth rate for Morocco seems likely. Although Morocco can be considered relatively well positioned to weather today's difficult economic and financial climate, and is also enjoying higher agricultural production from a strong harvest, the Economist Intelligence Unit (EIU) predicts that Morocco's economy will expand by just 0.6% in 2009. The EIU anticipates growth at 2.5% in 2010, but only if global demand for goods and services starts to recover by then.

The Moroccan government has launched several initiatives aimed at supporting the economy during the world recession and boosting infrastructure and welfare provision. Prospects for continued political stability are believed to depend closely on the government's success in dealing with the problems of unemployment, poverty, and social and economic exclusion. Thus, for political as well as economic reasons the government will increase social spending, including slum clearance, rural infrastructure, education, and health – both to deal with these problems and to offset the effects of the global economic downturn. Funds for public investment are being released faster than usual this year. However, limited resources, bureaucratic inefficiency, and widespread corruption and nepotism will complicate the government's efforts.

Tourism revenue is down. Receipts from tourism, an important source of foreign exchange, fell by 3.5% in 2008 and seem to be declining further this year. Although the number of tourist arrivals has risen, the rise is thought to be driven by Moroccans living abroad, who tend to stay in family homes rather than tourist accommodations.

Morocco has practiced improved economic management and instituted a number of important reforms over the past few years. In the 1990s King Mohammed VI set out a strong new vision for development, with more emphasis to be given to improving social conditions throughout the country. A program of reforms was then formulated, aimed at sustaining growth, energizing the labor market, reducing unemployment, raising the standard of living, and progressively eliminating poverty and exclusion. A dynamic and growing civil society (unusually strong for the region) also played an important role by helping to define and implement the social agenda and pushing for better governance.

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Public finances have been strengthened, but the cost of food and fuel subsidies remains a major challenge. The recent strong revenue performance of public revenues enabled the government to shield consumers from increases in world prices in 2008 without undermining macroeconomic stability. Over the medium term, however, better targeting of subsidies will be crucial. Gradually reductions in expenditure on subsidies will make room for more spending on investment and education, as well as for continued reduction in debt ratios.

Development in Morocco continues to face of formidable challenges. Major problems include vulnerability to drought, relatively low social indicators, high unemployment, and pressure on available natural resources, particularly water. A significant demographic transition has brought population growth under control, but the labor force continues to expand rapidly. The pace of economic growth was very slow in the 1990s but accelerated after 2000, with favorable impacts on poverty and unemployment. In the process, the economic structure became more diversified, reducing the importance of weather-dependent agriculture and increasing the economy's resilience to shocks. Nevertheless, a World Bank diagnostic conducted in 2006 identified four failures of government policy that were continued to hold back economic growth: (1) labor market rigidities; (2) a burdensome tax regime; (3) the fixed exchange rate regime; and (4) an anti-export bias despite free trade agreements. The Bank's analysis also found that growth is affected by three market failures: (1) limited circulation of information on intellectual property rights and investment opportunities; (2) weak coordination between the public and private sectors; and (3) lack of investment in human resource training by businesses. Morocco has maintained a high rate of physical investment, however, which rose from 23% of GDP in 2003 to 29% in 2005 and remained at that level through 2007.

The environment for private business has improved but substantial further improvement is needed to make Morocco truly business friendly. Morocco's ranking on the World Bank's ease of doing business index fell from 121st in 2006 to a lackluster 128th (out of 181 countries covered) in 2008, suggesting that the business environment is still not very favorable and also that other countries are reforming faster. According to the Bank's ratings, Morocco ranks relatively well on protecting investors (24th), closing a business (42nd), and getting credit (43rd), but it is weak on registering property (123rd), trading across borders (125th - the cost to exporters and importers is extraordinarily high), enforcing contracts (130th), paying taxes (139th), and dealing with construction permits (167th). Taxes on business are higher than in other countries in the Middle East and North Africa. The cost of getting a construction permit, measured both in time and in money relative to income per capita, is among the highest in the world.

The rate of unemployment was brought down through 2008 but remains high, especially among urban youth. Morocco's labor force was estimated at 11.3 million in 2006. The 2.5 million Moroccans who work in Europe constitute additional potential labor force that has been unable to find suitable employment at home. The demographic transition that brought down the birth rate will eventually cut the number of annual new labor force entrants, but at present some 200,000 are entering each year, many with inadequate education and training to prepare them for productive employment. Unemployment ran over 10% in the early 2000s but declined slightly to 9.7% by 2006. It is higher in urban settings (15.9% in 2007). The unemployment rate has been

stable so far in 2009 as job cuts in some manufacturing industries have been offset by higher employment in service activities.

The number of households living in absolute poverty is relatively small but there are significant pockets of poverty. Only 2% of the population was found to be living at less than \$1 per capita per day in purchasing power terms in 2000. The poverty head count is higher, however, in the rural areas and in less dynamic secondary urban areas (e.g., Fes and Chefchaouen).

Gender is an important issue in Moroccan economic development. Morocco performs poorly on every basic indicator of gender equity except female life expectancy. Most strikingly, while 86% of adult males participate in the labor force, only 29% of adult females do so. Poor integration of women into the workforce, while reflecting local cultural norms, undermines the country's productive potential. Greater effort to enhance opportunities for women to work outside the home would not only redress gender inequality but would also help alleviate poverty and boost economic growth.

Morocco's integration into the world economy is growing as the government has entered into several important free trade agreements, including one with the United States signed in 2006. Morocco's association agreement with the EU was signed in 2000 and becomes fully operative in 2012. It is of great importance because Morocco's leading trading partners are France and Spain. An FTA with the United States signed in 2006 led to a significant increase in textile exports and will continue to be phased in during the coming years. Although trade and financial relationships with other Maghreb countries are limited, efforts are being made to expand them. Further reductions in tariffs and simplification of the trade regime are needed to boost growth in trade. Morocco need to boost its commodity exports, which are considerably lower in value than its commodity imports. To cover the large deficit in the balance of trade, significant inflows of tourist receipts and worker remittances are needed.

Morocco has experienced financial development. Over the years, money supply has risen relative to GDP and the stock market has become better capitalized. Nevertheless, competition within the banking sector is nascent. Problems exist in the financial sector's ability to provide local firms with credit at reasonable rates of interest. Also worrisome is the concentration of banking activity in publicly owned banks, which together make up 40% of the banking sector's balance sheet. In response to these shortcomings, the World Bank has helped to improve the competitiveness of the financial sector by strengthening the legal, regulatory, and supervisory framework, increasing private participation in the banking sector, improving the transparency of corporate and accounting standards, and strengthening the financial information infrastructure. Soundness of lending practices should also be enhanced by the inauguration, in early 2008, of a privately managed credit bureau.

Consumer price inflation remains low and is now falling. Administered prices have not been adjusted since the beginning of 2007. With signs that the economy has been slowing since late 2008, that inflation is falling and that credit conditions are tightening, the central bank cut its policy rate from 3.5% to 3.25% in early 2009, the first reduction in six years. Although the central bank will move cautiously, a further small rate cut is possible. There is concern about the negative impact of the euro zone recession on investment and exports. The risk of a slump in

property prices may prompt a lowering of interest rates, given that recession in the euro zone will bite into European demand for second homes in Morocco, at a time when new housing supply is coming on stream. However, commercial lending rates will remain much higher. The central bank will also use other tools to control liquidity; reserve requirements were lowered from 15% to 12% in January 2009.

Morocco's infrastructure is of relatively high quality and does not impose a significant constraint on development. The government has paid continuing attention to the quantity and quality of the national infrastructure.

Water is a major issue in raising agricultural productivity. Although agriculture produces less than 20% of Morocco's GDP, it still employs 40% of the labor force. Much of the agricultural sector has low productivity and is vulnerable to water shortages. Production of wheat and oil seeds will also be face stiff foreign competition as free trade agreements come into effect and agricultural tariffs are lowered. There is also a high-value horticultural sub-sector that is more productive and less vulnerable. Only 14% of the planted area is irrigated, but it produces 50% of agricultural value added and 75% of the value of agricultural exports. The problem is that this sub-sector utilizes 85% of Morocco's water resources. Climate change, economic policy, and mounting demand for water from other economic sectors are straining the water supply. Anticipating a water shortage, the World Bank has been working with the government on a comprehensive water policy framework that links water use, pollution, and agricultural development.

Morocco receives strong support from the United States, the World Bank Group, and other aid donors. The World Bank will complete a five-year Country Assistance Strategy this year and is developing a new Country Partnership Strategy for the coming five years. USAID has worked with Morocco for many years. Its current programs stress economic growth, particularly successful responses to the challenges and opportunities presented by a more open trading environment. It also works on basic education for Moroccan children as well as job-related education to prepare young Moroccans for useful participation in work. Finally, USAID supports democratization activities and good governance reforms.

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